

REPORT OF THE
OFFICE OF THE AUDITOR GENERAL
TO THE
JOINT LEGISLATIVE AUDIT COMMITTEE

708

FINANCIAL AUDIT OF THE
TIDELANDS AND SUBMERGED LANDS
HELD IN TRUST BY THE CITY OF LONG BEACH
FOR THE STATE OF CALIFORNIA
YEAR ENDED JUNE 30, 1976

NOVEMBER 1977



Joint Legislative Audit Committee

OFFICE OF THE AUDITOR GENERAL

California Legislature



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November 22, 1977

708

The Honorable Speaker of the Assembly
The Honorable President pro Tempore of the Senate
The Honorable Members of the Senate and the
Assembly of the Legislature of California

Members of the Legislature:

Your Joint Legislative Audit Committee respectfully submits the Auditor General's financial audit of the Tidelands and Submerged Lands Held in Trust by the City of Long Beach for the State of California, Year Ended June 30, 1976. This is the first audit of Long Beach oil operations since 1971.

The auditors are Curt Davis, CPA; Dennis Sesler, CPA; Secundino Garcia and Dennis Reinholtsen.

Respectfully submitted,

MIKE CULLEN
Chairman

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AUDITOR'S OPINION

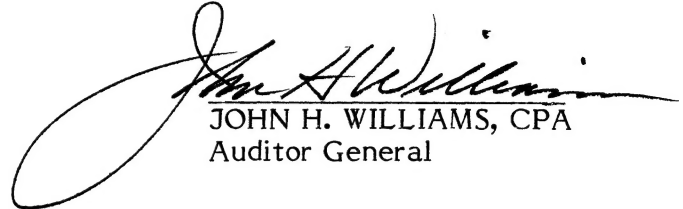
The Joint Legislative Audit Committee
of the California State Legislature

Pursuant to Chapter 138, Statutes of 1964, First Extraordinary Session, we have examined the Statement of Revenues Collected and Expenses Disbursed From Oil and Gas Operations from tidelands and submerged lands held in trust by the City of Long Beach, year ended June 30, 1976. Our examination was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As discussed in Note 8 to the Statement of Revenues Collected and Expenses Disbursed, the City of Long Beach and the State are involved in various suits and claims arising from Long Beach tidelands oil operations. According to legal counsel for the City and the State, the ultimate effect of such litigation cannot presently be determined.

In our opinion, subject to the effects, if any, on the Statement of Revenues Collected and Expenses Disbursed, of the ultimate resolution of the matter discussed in the preceding paragraph, the aforementioned Statement of Revenues Collected and Expenses Disbursed presents fairly

the revenues collected and expenses disbursed from oil and gas operations conducted on tidelands and submerged lands held in trust by the City of Long Beach for the State of California for the year ended June 30, 1976, classified on a cash basis consistent with that of the preceding year.



JOHN H. WILLIAMS, CPA
Auditor General

Dated: August 19, 1977

Staff: Curt Davis, CPA
Dennis Sesler, CPA
Secundino Garcia
Dennis Reinholtsen

CITY OF LONG BEACH
TIDELANDS AND SUBMERGED LANDS HELD IN TRUST

STATEMENT OF REVENUES COLLECTED AND EXPENSES DISBURSED
FROM OIL AND GAS OPERATIONS
YEAR ENDED JUNE 30, 1976

REVENUES COLLECTED

Net revenues collected from oil and wet gas contractors, per Schedule	\$87,981,000
Revenue collected from Harbor Upland Properties (Note 2)	355,000
Administrative overhead allowance (Note 3)	<u>825,000</u>
Total revenues collected from oil and wet gas operations	\$89,161,000
Dry gas sales (Note 4)	5,839,000
Oil production license tax credits (Note 5)	2,709,000
Miscellaneous revenue and interest	<u>169,000</u>
Total Revenues Collected	\$97,878,000

EXPENSES DISBURSED

City administrative and operating charges	\$2,443,000
Subsidence costs (Note 6)	829,000
State administrative charges	<u>1,369,000</u>
Total Expenses Disbursed	<u>4,641,000</u>
Net revenue collections available for distribution to the City of Long Beach and the State of California (Note 7)	<u>\$93,237,000</u>

The accompanying notes and Schedule are an integral part of this statement.

CITY OF LONG BEACH
TIDELANDS AND SUBMERGED LANDS HELD IN TRUST

SCHEDULE OF NET REVENUES COLLECTED
AND EXPENSES DISBURSED FROM OIL AND WET GAS CONTRACTORS
YEAR ENDED JUNE 30, 1976

	Contractors			Totals
	THUMS Long Beach Unit	Long Beach Oil Development Company	Powerine Oil Company Parcel "A"	
Gross revenues collected from oil and wet gas contractors	\$135,587,000	\$33,097,000	\$8,261,000	\$176,945,000
Salvage sales	<u>142,000</u>	<u>75,000</u>	<u>12,000</u>	<u>229,000</u>
Total Revenues Collected From Contractors	<u>\$135,729,000</u>	<u>\$33,172,000</u>	<u>\$8,273,000</u>	<u>\$177,174,000</u>
Less amounts disbursed and retained by operating contractors:				
Cost of oil and wet gas production expenses disbursed	\$ 60,432,000	\$20,089,000	\$4,618,000	\$85,139,000
Profits retained per contracts with the City of Long Beach	<u>2,761,000</u>	<u>1,006,000</u>	<u>287,000</u>	<u>4,054,000</u>
Total Expenses Disbursed and Retentions	<u>\$ 63,193,000</u>	<u>\$21,095,000</u>	<u>\$4,905,000</u>	<u>\$89,193,000</u>
NET REVENUES COLLECTED FROM OIL AND WET GAS CONTRACTORS	<u>\$72,536,000</u>	<u>\$12,077,000</u>	<u>\$3,368,000</u>	<u>\$87,981,000</u>

The accompanying notes are an integral part of this Schedule.

CITY OF LONG BEACH
TIDELANDS AND SUBMERGED LANDS HELD IN TRUST

NOTES TO STATEMENT OF REVENUES COLLECTED
AND EXPENSES DISBURSED FROM OIL AND GAS OPERATIONS
YEAR ENDED JUNE 30, 1976

1. Summary of Significant Accounting Policies

Chapter 138, Statutes of 1964, First Extraordinary Session, requires the City of Long Beach to monthly account for and pay to the State Lands Commission, for and on behalf of the State of California, all remaining oil revenue except the percentages or amounts specified to be retained by the City of Long Beach. Remaining oil revenue is defined by Chapter 138 as the oil revenue remaining after deducting and paying administrative and subsidence costs expended by the City and administrative costs expended by the State.

The City accounts for the tidelands oil revenues collected and expenses disbursed on the cash basis. The City holds the money it is required to pay the State as the latter's share of remaining oil revenue for approximately one month. The State has filed declaratory relief action against the City seeking to recover the interest the City earned on the oil revenue during the withhold period.

2. Revenue Collected from Harbor Upland Properties

The Harbor Upland wells are located on property purchased with tidelands money, and revenue therefrom is included with that earned from tidelands properties. The revenue received from the Harbor Uplands

is shown separately because its distribution to the City is based upon oil royalties and working interest ownership rather than net profit percentages, as is the case with revenues received from the operating contractors shown in the schedule.

3. Administrative Overhead Allowance

Under operating agreements with Long Beach Oil Development Company (LBOD) and Powerine Oil Company, the City is entitled to receive a six percent administrative overhead allowance. By agreement between the State and the City, the City is required to share with the State that portion of the administrative overhead allowance that pertains to the non-unit operations of LBOD and Powerine Oil Company after deduction of allowable city administrative charges. During fiscal year 1975-76 the allocated share of the administrative overhead allowance pertaining to non-unit operations was \$825,000.

4. Dry Gas Sales

The State receives the entire proceeds from the sale of dry gas.

5. Oil Production License Tax Credits

The City of Long Beach levies a tax of seven and one-half cents per barrel on oil produced from the tidelands, excluding the first 300 barrels of oil produced per well per quarter.

The State is exempt from payment of oil production license taxes levied by the City. Accordingly, the State is given a tax credit

based upon the State's allocable share of ownership in tidelands operations for the amount of oil production license taxes previously paid by the operating companies. The State's allowable credit for fiscal year 1975-76 is \$2,709,000.

6. Subsidence Costs

Chapter 138, Statutes of 1964, First Extraordinary Session, allows the City to retain out of oil revenue an amount equal to all subsidence costs expended by the City which are incurred for remedy or protection against the effect of subsidence of the land surface. During fiscal year 1975-76 this cost was \$829,000.

7. Net Revenue Collections Available for Distribution to the City of Long Beach and the State of California

The City's share of remaining oil revenue is currently limited to 20 percent, or a maximum of \$9 million per calendar year.

The amount of net oil revenue collections for fiscal year 1975-76 retained by the City at June 30, 1976 is comprised of the following:

City retentions July 1, 1975 - December 31, 1975	\$ 1,023,000
City retentions January 1, 1976 - June 30, 1976	7,451,000
Amount due the State from oil revenues for the month of June 1976	<u>7,434,000</u>
Portion of net revenue held by the City of Long Beach at June 30, 1976	<u>\$15,908,000</u>

The balance of net revenue collections in the amount of \$77,329,000 was distributed to the State of California during fiscal year 1975-76.

8. Litigation Concerning Long Beach
Tidelands Oil Operations

Several litigation matters involving Long Beach tidelands oil operations are underway.

The major disputes concerning the tidelands oil operations are two antitrust suits filed against the major oil companies in separate actions by the City of Long Beach and the State. The City's suit involves two charges. One count is a contract action whereby the City claims that the oil companies have not paid the City the highest price that they have paid among themselves for similar oil. The second charge is an antitrust count, alleging that the major oil companies "fixed" the price of crude oil. The State's antitrust suit differs from the City's antitrust suit in that the State's suit also involves the marketing of refined products to consumers.

The oil companies have filed counterclaims in the antitrust cases against the City and the State involving alleged violations of contractors' agreements, unit agreements, unit operating agreements and Chapter 138.

In addition to the antitrust issue, several disputes of less potential monetary magnitude have arisen. These disputes involve Federal

Energy Administration regulations, property tax assessment values and the City's retention of the interest earnings on the State's share of tidelands oil revenue.

Legal counsel for the various entities are unable to estimate the monetary effects that may result from these disputes and lawsuits.

COMMENTS

General

Through various legislative measures between 1911 and 1935, the City of Long Beach was made trustee of certain tidelands and submerged lands adjacent to the City. The grants were made for the development of navigation, commerce and fisheries. Oil was discovered on these lands in the late 1930's. A court decision allowed the City to retain the oil and gas revenues for the trust. In 1951, the Legislature released part of the revenues from the trust, permitting the City to spend it for municipal purposes. A 1955 court decision held that the revenues must be used for statewide benefit, and that those funds released from the trust reverted to the trustor, in this case the State. In 1956, the State Legislature stipulated that a portion of the oil revenues and all dry gas revenues derived from Long Beach tidelands be paid to the State.

Prior to 1965 about one-half of the Long Beach tidelands and submerged lands oil reserves remained undeveloped. Chapter 138,

Statutes of 1964, First Extraordinary Session, stated that this area should be developed for the benefit and profit of the State of California. This legislation provided for:

1. A further limitation of the City's share of the tidelands oil revenues to a sliding scale percentage ranging from 45 percent in 1969, to 20 percent subsequent to 1974, with a fixed maximum dollar amount of \$9 million per year to an eventual \$1 million per year after 1989.
2. Increased state responsibility for administration of the new oil field through state approval of an annual plan and budget, but with administration of the older portion of the field remaining primarily a city responsibility.
3. Deduction of subsidence-related costs from oil revenue before the split between the City and State (this has the effect of deducting 100 percent of subsidence costs from the State's share of oil revenues once the City reaches its maximum entitlement).
4. An annual audit by the Auditor General on the Long Beach tidelands revenues and expenditures and report thereon to the Legislature.

Distribution of Net Revenues Collected

The State's distribution of net revenues collected for the year ended June 30, 1976 is shown below:

Central Valley Water Project Construction Fund	\$ 5,000,000
California Water Fund	21,137,000
Capital Outlay Fund for Public Higher Education	<u>58,517,000</u>
Total	<u>\$84,654,000</u>

The above total includes \$7,325,000 distributed during fiscal year 1975-76 from revenues collected during the preceding fiscal year.

Cumulative Distribution of Trust Oil
Revenues Collected by the State

From February 1, 1956^{*} through June 30, 1976 the State has distributed tidelands trust revenues collected as shown below:

Water Projects	\$444,622,000
Capital Outlay for Public Higher Education	296,649,000
Southern California Rapid Transit District	3,700,000
General Fund	<u>250,000</u>
Total	<u>\$745,221,000</u>

* Prior to February 1, 1956, the State did not share in the Long Beach tidelands oil revenues.

Oil Price Controls
and Revenue Losses

The sales price of oil produced in the United States is controlled by federal regulations. In 1973, the Federal Energy Administration (FEA) established a two-tier pricing system that set a ceiling price on approximately 60 percent of domestic production. Most of the oil produced under Long Beach tidelands operations became subject to these price controls.

During 1976 a number of changes occurred in the FEA price control regulations resulting in increased crude oil ceiling prices. The most significant change occurred in October 1976, when the ceiling price of California crude oil was increased by approximately 60 cents per barrel.

If the price paid for Long Beach tidelands oil had approximated the decontrolled price of domestic and non-domestic oil, we estimate that additional proceeds of approximately \$290 million would have been realized during fiscal year 1975-76. This amount would have been realized by the State since the City's share of tidelands oil proceeds is currently limited to \$9 million.

Duplicate Audit Efforts

Duplicate tidelands auditing efforts have been a matter of concern for the State and the City of Long Beach for many years. The Long Beach City Auditor and the Office of the Auditor General have

cooperated by making audit workpapers, programs, procedures and findings available to each other in the hope of avoiding any unnecessary duplication of work.

Although this cooperative atmosphere has long existed between the two audit agencies, duplicate audit efforts are inevitable since the current system requires each agency to express independent audit opinions on financial records involving the same year.

The Long Beach City Charter requires the Long Beach City Auditor to audit all city funds. Tidelands oil revenues represent a part of these funds.

Chapter 138, Statutes of 1964, First Extraordinary Session, requires in part that:

Each year the Auditor General shall audit the Long Beach tideland revenues and expenditures and report thereon to the Legislature.

If both audit agencies are to continue annual audits of Long Beach tideland oil operations, a coordinated audit coverage of the operations would seem advisable. The Long Beach City Auditor concurs with the concept of a joint City-State audit and has expressed a desire to avoid the extensive duplication of effort involved in auditing the Long Beach oil operations.

CITY OF LONG BEACH



OFFICE OF THE CITY MANAGER

333 WEST OCEAN BLVD.
LONG BEACH, CALIFORNIA 90802

November 15, 1977

Joint Legislative Audit Committee
Office of the Auditor General
925 L Street, Suite 750
Sacramento, CA 95814

Attention: John H. Williams, Auditor General

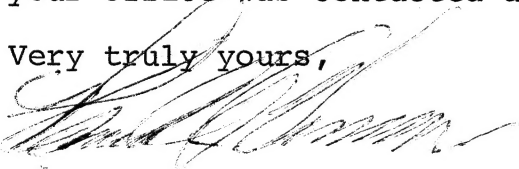
RE: 708

Dear Mr. Williams:

This replies to your letter of November 9, 1977, transmitting a copy of the draft report of the financial audit of the Tidelands and submerged lands held in trust by the City of Long Beach for the State of California, for fiscal year ending June 30, 1976.

Please be advised that this office has completed a review of this document and concurs in the findings as contained in the audit report. We have been pleased to review this matter with you; and in accordance with your suggestion, Mr. Curt Davis of your office was contacted and apprised of the City's position.

Very truly yours,


Randall J. Verrue
General Manager, Tidelands Agency

RJV:hf



ROBERT E. FRONKE, CPA
CITY AUDITOR

OFFICE OF THE CITY AUDITOR
CITY HALL
LONG BEACH, CALIFORNIA 90802
(213) 590-6751

November 14, 1977

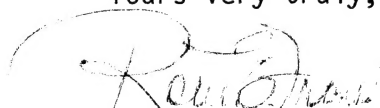
Mr. John H. Williams
Auditor General
State of California
925 L Street, Suite 750
Sacramento, California 95814

Dear John:

As requested in your letter of November 9, 1977, we have reviewed the draft of your audit report of Long Beach Tidelands for the fiscal year ended June 30, 1976.

Please be advised that we are in concurrence with the joint audit concept and have no objections to the report draft.

Yours very truly,


ROBT E. FRONKE
City Auditor

REF:JWH:aoh

STATE LANDS COMMISSION

STATE LANDS DIVISION

100 OCEANGATE—SUITE 300
LONG BEACH, CALIFORNIA 90802
TEL NO.: (213) 590-5201

TO: DIANE JONES

FROM: W. M. THOMPSON



November 16, 1977

Re: Financial Audit, Long Beach
Tidelands, Year Ending June 30,
1976

Mr. Curt Davis
Office of Auditor General
1100 K Building, Room 400
Sacramento, CA 95814

Dear Mr. Davis:

Thank you for giving us the opportunity to comment on your draft of the financial audit of Long Beach tidelands for the year ending June 30, 1976.

The Commission staff has reviewed this audit and finds that, other than a few minor matters of language which have been discussed between your staff and Mr. W. E. Pace and Mr. Jim Yoshimura of our staff, we have no recommendation for corrections or revisions.

Sincerely,

A handwritten signature in dark ink, appearing to read "W. M. Thompson", written over the typed name.

W. M. THOMPSON
Manager
Long Beach Operations

WMT:eo

cc: Wm. F. Northrop

Office of the Auditor General

cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
Secretary of State
State Controller
State Treasurer
Legislative Analyst
Director of Finance
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
California State Department Heads
Capitol Press Corps